No. 359

# In the Supreme Court of the United States

OCTOBER TERM, 1941

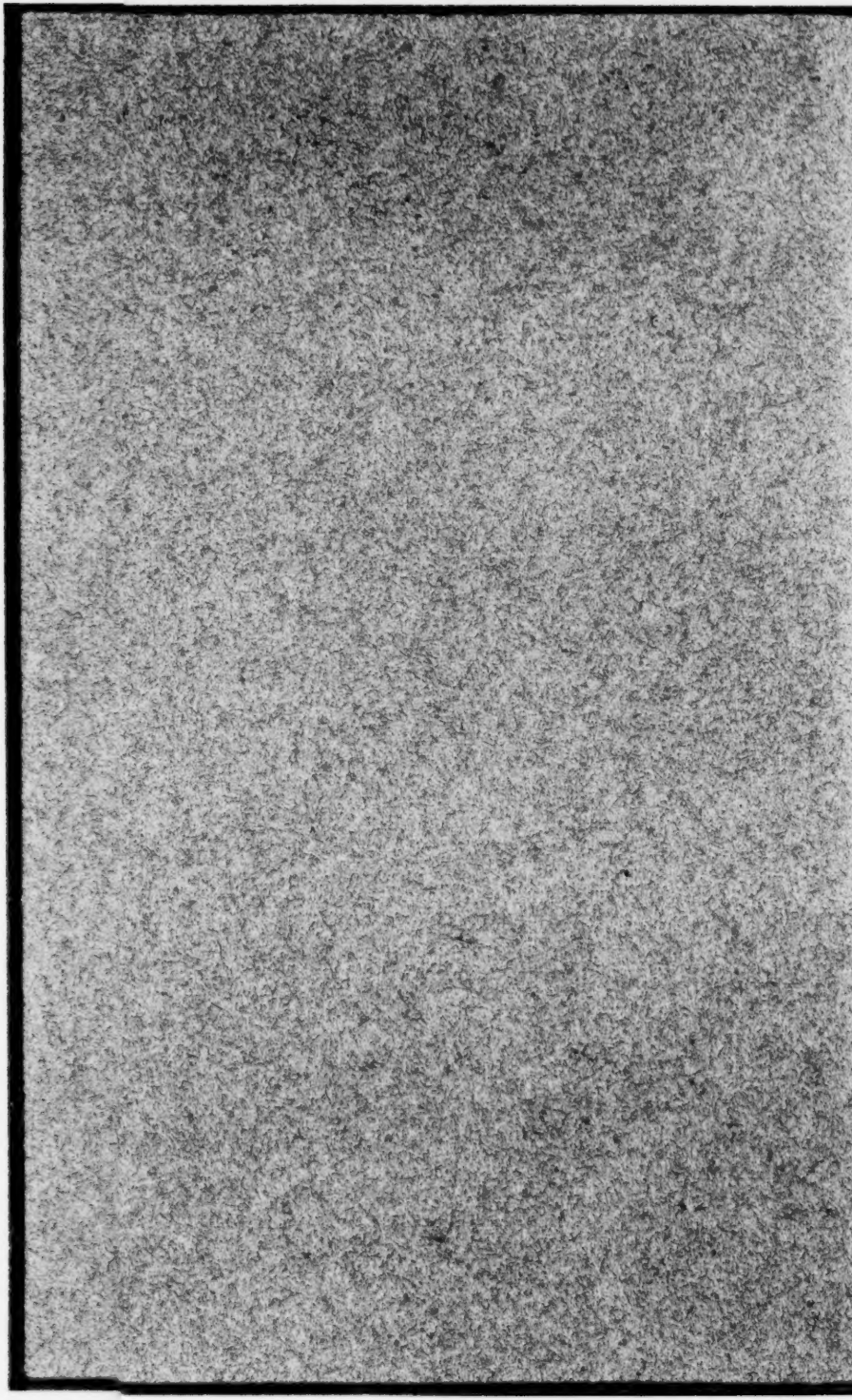
CHITTENDEN CONSOLIDATED IRRIGATION ASSOCIATION, INC., PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION



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### OPINIONS BELOW

The opinion of the District Court (R. 30–38) is reported in 39 F. Supp. 85.

The opinion of the Circuit Court of Appeals for the Second Circuit (R. 46–53) is reported in 120 F. (2d) 738.

### JURISDICTION

The decree of the Circuit Court of Appeals was filed on June 23, 1941 (R. 53). The petition for

a writ of certiorari was filed on August 8, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

### QUESTION PRESENTED

Whether the petitioner has engaged in the "sale" of a security within the meaning of Section 5 (a) of the Securities Act of 1933, as amended, and, if so, whether the sale is exempt under the provisions of Section 4 (1).

### STATUTE INVOLVED

The pertinent provisions of the Securities Act of 1933, as amended, are found in the Appendix.

### STATEMENT

This case was decided by the District Court upon cross motions for judgment on the pleadings (R. 27, 28). The facts set forth in the complaint (R. 4–25), admitted in the answer (R. 26), may be summarized as follows:

On September 1, 1937, the Government of the Republic of China authorized the issuance of $500,000,000 principal amount of bonds known as "4% Liberty Bonds of the Twenty-sixth Year of the Republic of China" (hereinafter referred to as "Liberty Bonds"), and on May 1, 1938, that Government authorized the issuance of $50,000,000 principal amount of "5% United States Dollar

Bonds" (hereinafter referred to as "U. S. Dollar Bonds") (R. 5).

Petitioner is a New York corporation with a membership of approximately 25,000 Chinese (R. 5). On October 8, 1937, just one month after the authorization of the Liberty Bonds, the petitioner organized a committee known as the General Relief Fund Committee (hereinafter referred to as the "Committee"). The purposes for which this Committee was formed include "aiding * * * the Government of China" and "to solicit and receive funds * * * for transmittal to China for general relief purposes" (R. 6).

By means of advertisements inserted in newspapers which were sent through the mails, as well as by mass meetings and personal appeals, the Committee has urged the members of Chinese communities in New York, New Jersey, and Connecticut to purchase Chinese Liberty Bonds and Chinese U. S. Dollar Bonds and has offered to accept funds for the purchase of bonds from the individuals with whom it has communicated (R. 6–7).

As a result of its activities, the Committee has received a sum in excess of $600,000 to be used for the purchase of Liberty Bonds and U. S. Dollar Bonds (R. 7). The funds collected have been delivered to the New York Agency of the Bank of China, which transmits them through the mails to a branch of the bank in Hong Kong, China, with instructions to purchase the bonds. The bonds are

returned through the mails to the bank in New York, which in turn sends them through the mails to the purchasers (R. 7–8). In some cases, the bonds have been mailed to the purchasers in care of the petitioner (R. 8). No charge is made by the Committee for its services in connection with the receipt and transmittal of funds to be used for the purchase of bonds, nor do the members of the Committee receive compensation from any other source in connection with its activities (R. 8–9). The Committee and its members have no official or contractual connection with the Republic of China or any branch thereof (R. 6).

No registration statement under the Securities Act has ever been in effect for either the Liberty Bonds or the U. S. Dollar Bonds (R. 5). Despite this fact, the petitioner has used the mails and the instruments of interstate and foreign commerce, or has caused those means to be used, in soliciting purchases of the bonds, in the transmittal of funds to China, and in delivering the securities after sale to residents of the United States (R. 7–8).

The present suit was commenced by the Securities and Exchange Commission on June 12, 1940 by the filing of a complaint seeking an injunction restraining petitioner from using the mails or any means or instruments of interstate commerce to carry on its activities in connection with the Chinese bonds without registration (R. 10). On cross motions for judgment on the pleadings, the District Court dismissed the complaint (R. 3–4).

The court below reversed (R. 53), one judge dissenting (R. 52–53).

## ARGUMENT

The decision of the court below is not in conflict with any decision of this Court or of any other circuit court of appeals and presents no question calling for review by this Court. Although the applicability of important provisions of the Securities Act of 1933 is in issue, these provisions were, we believe, correctly construed by the court below.

1. There can be little question that the petitioner's activities constituted a violation of Section 5 (a) of the Act, unless they are excluded from the operation of Section 5 (a) by the provisions of Section 4 (1). Section 5 (a) provides that it shall be unlawful for any person, including a corporation such as petitioner and a foreign government such as the Republic of China (Section 2 (2)), to use the mails or any instrument of interstate commerce for the sale, or delivery after sale, of a security unless a registration statement as to that security is in effect. Here there was admittedly a use of the mails and the instruments of interstate commerce in connection with a security as to which no registration statement was in effect. The only question raised in this connection is whether petitioner's activities involved a "sale" or a "delivery after sale."

With respect to that question Section 2 (3) of the Act is decisive. It provides that the term "'sale' * * * shall include every * * *

attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value * * *."[1] The admitted fact is that petitioner urged residents of the United States to purchase bonds of the Chinese Government, offering its services as agent for the purchasers in the consummation of the sale. This activity plainly constituted a "solicitation of an offer to buy a security" within the meaning of Section 2 (3).[2]

The fact that petitioner acted as agent for the purchasers in transmitting the funds it collected does not alter the character of its action in soliciting offers to buy. Clearly petitioner did not act as agent for the prospective purchasers when it first approached them; yet it was at that time that petitioner solicited the offers to buy and thereby

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[1] It is clear that Congress intended by this definition to ascribe to the word "sale" a broader connotation than that ascribed to it in common usage. The House Report on the bill which became the Securities Act of 1933 stated: "Paragraph (3) defines the term 'sale' or 'sell' broadly to include every attempt or offer to dispose of a security for value." H. Rpt. No. 85, 73d Cong., 1st sess., page 11.

[2] Petitioner contends (Pet. 14–15) that the only purpose of including "solicitation of an offer to buy" within the statutory definition of "sale" was to prevent dealers from making offers to buy securities between the filing of the registration statement and its effective date. This contention, of course, has no warrant whatever in the statutory language. The statement quoted from H. Rpt. No. 85, 73d Cong., 1st sess., in support of the contention dealt with language which was not retained in the statute as enacted and which is not in the definition of "sale" in the Act as it now stands.

engaged in "selling" within the meaning of the Act. It was only after the solicitation was made—and Section 5 (a) thereby violated—that petitioner did anything on behalf of the purchasers.

2. Petitioner's activities are not exempted from the operation of Section 5 (a) by the provisions of Section 4 (1). Section 4 (1) provides as follows:

> The provisions of section 5 shall not apply to any of the following transactions:
>
> (1) Transactions by any person other than an issuer, underwriter, or dealer; * * *

This section is inapplicable to the activities of the petitioner for two reason: (a) because petitioner's activities constitute an integral part of a transaction by an issuer; and (b) because petitioner is itself in the position of an "underwriter" as defined by the Act.

(a) In its petition, petitioner treats Section 4 (1) as though it exempted from the provisions of Section 5 (a) all activities of any person other than an issuer, underwriter, or dealer. This is not, however, what Section 4 (1) either states or means. The exemption is limited to "transactions" by any person other than an issuer, underwriter, or dealer. It thus leaves subject to the Act all activities, no matter by whom carried out, which are part of a transaction of sale by an issuer. The exemption applies only when the activities are not part of such a transaction, as, for example, ordinary trading transactions between individual investors.

Petitioner's construction of Section 4 (1) is clearly contrary to the Congressional purpose. The aim of the Act as a whole is to require disclosure of material facts concerning securities when they are the subject of distribution by an issuer or controlling stockholder; it imposes no registration requirement when the securities are the subject of ordinary sales between individual investors.[3] Section 4 (1) draws the line of distinction by exempting from the registration procedure transactions which are not customarily a part of the distribution process, that is, transactions in which neither an issuer, an underwriter, nor a dealer (selling during the period of distribution) takes part. But the section does not, and was not intended to,[4] grant an exemption to any person performing an essential function in the distribution of securities by an issuer.

The activities of the petitioner here, as the court below held (R. 51), are plainly an integral part of a transaction by an issuer. A new issue of bonds is being sold to residents of the United States.

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[3] The Securities Exchange Act of 1934 regulates trading in securities as distinguished from the distribution of securities.

[4] The House Report on the bill which became the Securities Act of 1933 states the following with respect to Section 4 (1): "Paragraph (1) broadly draws the line between *distribution* of securities and *trading* in securities, indicating that the Act is, in the main, concerned with the problem of distribution as distinguished from trading." (Italics supplied.) H. Rpt. No. 85, 73d Cong., 1st sess., p. 15.

Petitioner, although it is not in a contractual relationship with the issuer and is motivated by patriotism rather than profit, is nonetheless the active party soliciting purchases in this country. The purchase price is transmitted to the Republic of China, the issuer. There is no separate and distinct transaction carried through by the petitioner: its solicitation merely initiates a transaction to be completed by the Republic of China. Since each completed transaction is one effected by an issuer, the transaction is not exempt under Section 4 (1).

(b) The second reason why no exemption is available under Section 4 (1) is that petitioner is in the position of an underwriter as defined by the Act. Section 2 (11) defines "underwriter," in part, as any person who "sells for an issuer in connection with the distribution of any security * * *." As pointed out above, petitioner clearly "sells" Chinese bonds within the meaning of the statute because it solicits offers to buy these securities. It is also clear that petitioner solicits these offers to buy for the benefit of the issuer: it has collected over $600,000 in subscriptions and has transmitted this amount to China for the purchase of bonds (R. 1).

Petitioner contends, however, that it is not selling "for an issuer," even though it may be selling for the benefit of an issuer, because it has no contractual or agency relationship with the Republic of China (Pet. 16–18). This contention miscon-

ceives the nature of the Securities Act. The aim of the statute is to have information available for investors before any securities may be distributed to residents of the United States. The exact nature of the relationship between the issuer and the person who solicits the offers to buy the securities is immaterial to the purposes of the Act; investors need the information afforded them by the registration procedure quite as much when the person who "sells" them the security is a volunteer rendering services for the issuer out of motives of patriotism, as when the person is a commercial underwriting firm, acting for profit under a contractual relationship with the issuer. In either case, the person is an "underwriter" because it is by means of his solicitation of offers to buy that a distribution of securities by the issuer is effected.

3. There is no merit in petitioner's suggestion that, even if the Commission is entitled to relief, resort should be had to diplomatic intervention rather than to the injunctive process (Pet. 23). Congress designated a method by which the Commission may put a halt to violations of the Act: in Section 20 (b) it authorized the Commission to seek an injunction in the courts. It designated this remedy despite the fact that the Act is specifically applicable to securities issued by a foreign government. Petitioner advances no reason why the remedy provided by Congress should not be available in the circumstances of this case

4. The identical questions presented in this case were presented in five similar proceedings brought by the Commission against other Chinese organizations engaged in selling in this country Liberty Bonds and U. S. Dollar Bonds of the Chinese Government. In all of these cases, consent injunctions were obtained.[5] In one other case the Commission obtained a consent injunction against a patriotic bond subscription society selling Japanese bonds in Hawaii by substantially the same methods as those employed by petitioner.[6] No other similar cases are now pending.

5. The Commission wishes to emphasize, as it did in the courts below, that its action in instituting the present proceeding was not motivated by a desire to prevent the sale of Chinese securities in the United States. The Commission has, of course,

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[5] *Securities and Exchange Commission* v. *Chinese Patriotic Society and Chinese Consolidated Benevolent Association of Fresno, Chinese Relief and Refugee Association*, Civil Action, File No. 643RJ (S. D. Cal., Nov. 2, 1939); *Securities and Exchange Commission* v. *Chinese Benevolent Association of Philadelphia*, Civil Action, File No. 786 (E. D. Pa., March 4, 1940); *Securities and Exchange Commission* v. *The China Society*, Civil Action No. 220 (D. Ore., Oct. 30, 1939); *Securities and Exchange Commission* v. *China War Relief Association of America et al.*, Civil Action, File No. 21404R (N. D. Cal., Nov. 3, 1939); *Securities and Exchange Commission* v. *The Seattle Chinese Patriotic League*, Civil Action, File No. 116 (W. D. Wash., Oct. 23, 1939).

[6] *Securities and Exchange Commission* v. *Patriotic Bond Subscription Society of Hawaii, and Kango Kawasaki, et al.*, Equity No. 733 (D. Hawaii, Jan. 20, 1939).

no reason to object to the sale of such securities if they are registered in accordance with the provisions of the Securities Act; in fact, upon proper representations, the Commission would undoubtedly exercise its full discretion to expedite such registration. It is plain, however, that the Commission cannot ignore petitioner's obvious violation of the Act without opening the way for violations by other persons with less worthy motives.

## CONCLUSION

It is respectfully submitted that petition for a writ of certiorari should be denied.

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